

Message Text

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ACTION EUR-25

INFO OCT-01 EA-11 ISO-00 EURE-00 SSO-00 NSCE-00 USIE-00

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SS-20 STR-08 OMB-01 CEA-02 CIAE-00 COME-00 FRB-02

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TO SECSTATE WASHDC IMMEDIATE 5483

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DEPARTMENT OF TREASURY WASHDC IMMEDIATE

LIMITED OFFICIAL USE SECTION 1 OF 2 ROME 8551

E.O. 11652: N/A

TAGS: EFIN, IT

SUBJECT: RESOLUTION OF ITALIAN GOVERNMENT CRISIS -- AGREEMENT
REACHED ON ECONOMIC STABILIZATION PROGRAM

REF: A. ROME 7514 DATED MAY 31, 1974

B. ROME 8499 DATED JUNE 19, 1974

C. ROME 14067 DATED DECEMBER 18, 1973

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D. ROME 4909 DATED APRIL 8, 1974

1. SUMMARY. AFTER SECOND DAY OF INTENSIVE MEETINGS, RUMOR GOVERNMENT ON JUNE 19 RESOLVED INTER-PARTY DIFFERENCES AND AGREED ON TERMS OF ECONOMIC STABILIZATION PROGRAM. ACCORDING TO TERMS OF FISCAL AND CREDIT PACKAGE, VARIOUS DIRECT AND INDIRECT TAX INCREASES WILL PRODUCE SOME 3,000 BILLION LIRE (\$4.6 B. AT \$1 EQUALS 652 LIRE) IN ADDITIONAL GOVERNMENT REVENUE, GLOBAL CREDIT EXPANSION FOR PERIOD MARCH 1974 THROUGH MARCH 1974 WILL BE LIMITED TO 22,400 BILLION LIRE, ON A SELECTIVE BASIS BOTH SPECIAL CREDIT FOR SMALL AND MEDIUM BUSINESS AND THE SOUTH AND ORDINARY COMMERCIAL CREDIT WILL BE EASED. ALTHOUGH BOTH SOCIALISTS AND CHRISTIAN DEMOCRATS COMPROMISED ON CREDIT AND FISCAL COMPONENTS OF PACKAGE, ECONOMIC PROGRAM ON WHILE FOLLOWS CARLI-COLOMBO LINE AND THEREFORE MAKES CREDIBLE GOI COMMITMENT TO PUT DOMESTIC ECONOMY IN ORDER AND BALANCE EXTERNAL ACCOUNTS. GOVERNMENT WILL PRESENT ECONOMIC PROGRAM TO PARLIAMENT NEXT WEEK FOR DEBATE AND VOTE OF CONFIDENCE AND WILL THEN MEET WITH LABOR UNIONS. ONLY AFTER THESE CONSULTATIONS ARE CONCLUDED WILL GOI ISSUE DECREE LAWS TO PUT TAX AND CREDIT MEASURES INTO EFFECT. END SUMMARY.

2. ON EVENING OF JUNE 19, PRIME MINISTER RUMOR ANNOUNCED THAT CENTER-LEFT COALITION HAD REACHED AGREEMENT ON ECONOMIC PROGRAM OF INTEGRATED FISCAL AND CREDIT MEASURES DESIGNED TO CONTAIN INTERNAL DEMAND AND FINANCE INVESTMENT IN BOTH PRODUCTIVE AND SOCIAL SERVICES SECTORS. RUMOR ALSO ANNOUNCED THAT ECONOMIC STABILIZATION PROGRAM WILL BE PRESENTED TO PARLIAMENT FOR DEBATE AND VOTE OF CONFIDENCE. AFTERWARDS, GOVERNMENT WILL DISCUSS PROGRAM WITH LABOR UNIONS AND THEN ISSUE IMPLEMENTING DECREE LAWS WHICH MUST BE APPROVED BY PARLIAMENT WITHIN 60 DAYS.

3. FISCAL PROGRAM. CONTENTS OF FISCAL PACKAGE APPEAR ON THE WHOLE TO AGREE WITH DESCRIPTION REPORTED REF B. NEVERTHELESS, SOME PRESS REPORTS ON JUNE 20 INDICATE MINOR CHANGES WERE MADE SUCH AS DROPPING THE PROPOSED SUPPLEMENTARY TAX ON USE OF TV'S AND ALTERING INCREASES IN VALUE-ADDED TAX RATES ON CERTAIN ITEMS. (WE WILL LIMITED OFFICIAL USE

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PROBABLY HAVE TO WAIT FOR DECREE LAWS TO BE ISSUED BEFORE KNOWING PRECISE DETAILS OF TAX PACKAGE.) ELEMENTS OF COMPROMISE BETWEEN SOCIALISTS AND CHRISTIAN DEMOCRATS ARE CLEARLY EVIDENT IN FISCAL PACKAGE, ALTHOUGH ON WHOLE IT WOULD APPEAR CARLI-COLOMBO PROPOSALS PREVAILED. NOT ONLY IS TAX BURDEN SPREAD OVER WHOLE INCOME SCALE, BUT TOTAL ESTIMATED REVENUE OF 3,000 BILLION LIRE IS VERY CLOSE TO LEVEL CARLI HAD CITED WAS NECESSARY IF

FISCAL POLICY ALONE WAS USED TO CONTAIN BALANCE OF
PAYMENT DEFICIT (REF A). AT SAME TIME, SOCIALISTS MAN-
AGED TO ACHIEVE SOME EASING IN INCOME TAX BURDEN ON LOWER
INCOME GROUP WHILE SHIFTING WEIGHT OF DIRECT TAX BURDEN
MORE HEAVILY ON TO UPPER INCOME GROUP.

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4. CREDIT PROGRAM. AS RESULT OF SPECIAL MEETING AMONG
BUDGET, TREASURY AND FINANCE MINISTERS, A COMPROMISE WAS
REACHED ON CREDIT PROGRAM. TREAS MIN COLOMBO WAS ABLE TO

SECURE AGREEMENT TO RETURN TO GLOBAL CREDIT CEILING OF 22,400 BILLION LIRE FOR PERIOD MARCH 74 THROUGH MARCH 75 WHILE AT SAME TIME CONCEDING THAT SOME SELECTIVE EASING OF BOTH ORDINARY AND SPECIAL CREDIT BE MADE. RELAXATION OF "SPECIAL" CREDIT WILL BE EFFECTED THROUGH TWO MEASURES: LIMITED OFFICIAL USE

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A. REQUIREMENT THAT COMMERCIAL BANKS INCREASE PURCHASES OF BONDS ISSUED BY SPECIAL CREDIT INSTITUTES SO THAT TOTAL HOLDINGS WILL EXCEED 1972 HOLDINGS BY AT LEAST 12 PERCENT (PREVIOUSLY 9 PERCENT) OF THEIR DEMAND AND SAVINGS DEPOSITS AS OF DECEMBER 31, 1972. THIS WILL ENABLE SPECIAL CREDIT INSTITUTES TO EXTEND LONG-TERM FINANCING ON ORDER OF 2,000 BILLION LIRE TO SMALL AND MEDIUM INDUSTRIES AND FINANCE INVESTMENT IN SOUTH.

B. ESTABLISHMENT OF A 500 BILLION LIRE FUND FOR EXTENSION OF CREDIT TO SMALL AND MEDIUM INDUSTRIES AND FINANCING INVESTMENT IN THE SOUTH. ONE HALF OF FUND'S CAPITAL IS TO BE DERIVED FROM TAX REVENUES RESULTING FROM NEW FISCAL PACKAGE. OTHER HALF IS TO COME FROM SPECIAL CREDIT INSTITUTES, WHICH ENGAGE IN MEDIUM AND LONG-TERM LENDING. BECAUSE OF WAY IT IS STRUCTURED, THIS SPECIAL CREDIT FUND WILL BE INOPERABLE UNTIL REVENUES FROM NEW TAX INCREASES ARE ACTUALLY COLLECTED AND SPECIAL CREDIT INSTITUTES BEGIN TO EXPERIENCE INFLOW OF FUNDS AS A RESULT OF COMMERCIAL BANKS PURCHASING THEIR BONDS. THIS REPRESENTS A CRUCIAL POINT IN COMPROMISE BETWEEN TREAS MIN COLOMBO (CHRISTIAN DEMOCRAT) AND BUDGET MINISTER GIOLITTI (SOCIALIST) ON COORDINATING TIMING OF EASING CREDIT POLICY WITH TAX INCREASES. IN AREA OF ORDINARY COMMERCIAL CREDIT, LIMITATION ON TOTAL BANK LENDING HAS BEEN EASED BY INCREASING FROM 30 MILLION LIRE TO 60 MILLION LIRE SIZE OF LOANS TO INDIVIDUAL CLIENTS, THE TOTAL AMOUNT OF WHICH MAY NOT INCREASE BY MORE THAN 15 PERCENT FROM END MARCH 74 TO END MARCH 75. IN ADDITION, FINANCIAL MINISTERS AGREED THAT THE MINISTERIAL CREDIT COMMITTEE WILL MEET BY SEPTEMBER 30 TO EXAMINE ECONOMIC SITUATION TO DETERMINE WHETHER CREDIT CAN BE FURTHER EASED. SUCH ADDITIONAL RELAXATION WOULD DEPEND UPON EFFECTIVENESS OF TAX PROGRAM.

5. COMMENT. AFTER EXHAUSTIVE DELIBERATIONS IN CRISIS ATMOSPHERE, RUMOR GOVERNMENT HAS SUCCEEDED IN PUTTING TOGETHER WHAT APPEARS TO BE A VIABLE ECONOMIC STABILIZATION PROGRAM. NOT ONLY HAVE THEY REAFFIRMED COMMITMENT TO GLOBAL CREDIT CEILING AGREED TO IN IMF LETTER OF INTENT, BUT THEY HAVE COME UP WITH TAX PACKAGE WHICH PRODUCES LEVEL OF REVENUE GOVERNOR CARLI INDICATED IS NECESSARY BOTH TO DAMPEN INTERNAL DEMAND AND REDUCE BALANCE OF PAYMENTS DEFICIT. IN LIMITED OFFICIAL USE

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ADDITION, COLOMBO WAS ABLE TO INSURE THAT PART OF
SELECTIVE CREDIT EASING WOULD BE TIED TO SUCCESS OF
TAX MEASURES. IT IS CLEAR THAT IN COMMITTING ITALY TO
RESPONSIBLE STABILIZATION PROGRAM, GOI WAS FULLY AWARE OF
NEED TO TAKE DECISIVE STEPS TO SECURE FAVORABLE REACTION
FROM INTERNATIONAL COMMUNITY. IF SUCH REACTION IS
FORTHCOMING, ITALY SHOULD BE ABLE TO OBTAIN ADDITIONAL
EXTERNAL FINANCIAL ASSISTANCE TO HELP WEATHER WHAT WILL
CONTINUE TO BE DIFFICULT ECONOMIC ADJUSTMENT PERIOD. VOLPE

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